The Venture Capital Industry

A Preqin Special Report

October 2010

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The Venture Adventure

This special Preqin report will look at the venture capital industry from all angles. Using data and intelligence taken from Preqin's suite of online databases, we show how the industry has performed, the size and scope of active firms worldwide, latest fundraising statistics and the views of institutional investors on venture capital allocations.

The venture capital industry as we know it today can trace its roots back to the 1970s, which saw the inception of a number of Sand Hill Road investment firms along with the establishment of the NVCA in 1973. The following forty years have seen a number of ups and downs in the industry, with the 1980s seeing a period of industry growth amidst variable performance, the late 1990s delivering exceptional performance with a surge in fundraising, and the past ten years seeing disappointing returns and fundraising taking place at a far lower level than in the late 90s.

Within Europe especially, overall fundraising has troughed following numerous years of disappointing returns leading to investor indifference. Figures for the US are also failing to live up to expectations, but there are signs of growth within Asian and Rest of World markets, where fundraising peaked in 2008 at $23 billion – a higher total than that seen in Europe and a similar level to the US.

Although overall fundraising totals and overall performance returns have proven to be disappointing, there are a number of bright spots within the industry.

As our performance analysis shows, although overall performance statistics are somewhat disappointing, there are a significant minority of venture managers that provide very strong returns. Data taken from Preqin's Performance Analyst shows that while the days of funds exhibiting 100%+ IRRs may be behind us, nearly 20% of 2005 vintage funds currently have net IRRs in excess of 20%. The evidence for manager expertise within the venture sector is compelling. 70% of firms appearing in the top quartile have seen their follow-on vehicle exceed the median, with a number of firms having seen the majority of all funds raised appearing in the top quartile. While some firms have struggled to raise capital, those managers with a strong track record have provided a more compelling case for investment, and raised new vehicles in relatively quick time, even in the current financial climate.

Certain areas within the market are seeing a clear increase in interest, with opportunities in cleantech and renewable energy leading to a number of new industry-specific firms and funds being established over the past few years. There are also exciting opportunities in emerging markets, with growth being fuelled following a surge in interest from institutional investors located both locally, and also from the US and Europe. This report includes an overview of the makeup of active venture firms by type and geography, using data from the Preqin's Funds in Market and Fund Manager Profiles products, while information collected from our Investor Intelligence service enables us to examine which investors are actively considering making new commitments.

Although there are more positive aspects within the industry, current sentiment towards the market is understandably mixed; some claim that the venture capital model is broken, while others believe that an evolution is required if the industry is to improve upon the overall performance experienced in the past 10 years.

There are arguments that improvements in technology have made it cheaper to launch new businesses, contrasting with the trend of larger funds which search for higher minimum investments. We have seen an increasing number of 'Super Angels' coming forward to fill the gap, raising smaller vehicles with more private capital than traditional funds in order to access these opportunities. With many firms now competing for larger deals, there is also talk of prices being driven up, therefore endangering future returns for investors.

Our data and analysis suggests that the venture capital fund market is often over-simplified. The reality is that overall industry performance may be disappointing, but there are also many success stories, growth areas, and an elite group of firms that are consistently providing investors with excellent returns.

Whether venture capital continues to be available via traditional fund structures, from 'Super Angels', or from other means, it is certain that for the time being it remains a vital asset class capable of driving growth, innovation and the overall economy. We hope that you find the data in this special Preqin venture capital industry report to be interesting and informative, and as ever we welcome any feedback that you may have.

The Venture Landscape

The Preqin database provides details for over 3,500 firms located across the globe making venture capital investments, of which 1,365 manage specific closed-end venture capital funds. Fig. 1 shows historical fundraising for venture firms since 1998 and the geographic focus of the respective funds.

Fundraising

Over 3,700 venture vehicles have raised $558 billion since 1998, with North America-focused funds consistently raising the most capital each year. The largest annual amount raised was by funds closing in 2000; this record figure came as a result of the dot-com boom. North America-focused funds were responsible for raising 75% of the $84 billion raised by venture firms in 2000 and account for 63% of the total capital raised by the sector since 1998. However, Asia and Rest of World-focused funds have become more prominent within the venture market, and were responsible for 37% of the $62 billion raised in 2008.

Fig. 2 reveals that 49% of the 1,365 venture fund managers are headquartered in North America. Europe hosts 25% of venture firms, and Europe-focused funds have raised 16% of aggregate capital commitments between 1998 and 2010. 25 Europe-focused funds have closed in 2010 to date, raising $7.6 billion in capital commitments. A quarter of venture firms are located in Asia and Rest of World, and this figure is likely to increase as emerging economies continue to develop.

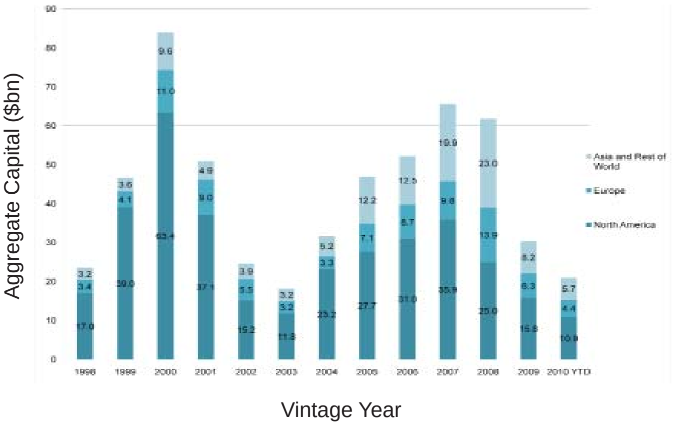
Venture Investment Stage

Fig. 3 displays a breakdown of venture funds by their investment stage focus. Venture funds with no specific stage focus have consistently raised the largest proportion of overall venture capital fundraising and so far in 2010, 39% of the venture funds that have closed have no specific investment stage preference. For the purpose of this analysis, early stage funds include all those funds that have a marked inclination towards seed and start-up investments. Early stage funds raised $12.3 billion in 2005, but since then have garnered less capital from investors year on year, irrespective of growth or decline in the aggregate capital raised by venture funds.

Since 2005, expansion funds have consistently increased their annual share of the venture fundraising market. Of the $30.3 billion raised by all venture funds in 2009, expansion funds accounted for a record 37%, and since 2005 they have raised an aggregate $65.8 billion. Pine Brook Road Partners I is one of the ten largest venture funds to close since 2005, having secured $1.4 billion in capital commitments by its final close in April 2009. The fund was raised to provide expansion capital to new or near-new energy and financial services businesses that are looking to grow and expand.

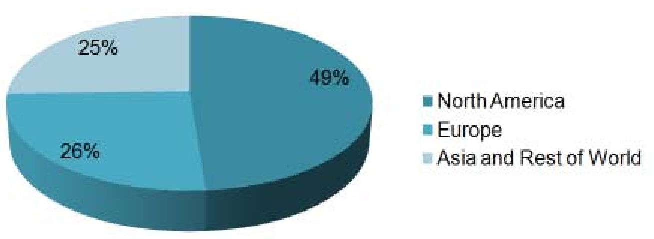
Late stage funds are often raised by specialized later stage venture capital firms such as the Silicon Valley-based Meritech Capital Partners. 2010 has already seen four late-stage venture funds close, raising an aggregate $1.8 billion, and one of the largest venture funds to close recently was the late stage-focused Institutional Venture Partners XIII. California-based Institutional Venture Partners closed its eighth technology fund in June 2010 on $750 million, significantly surpassing its initial $600 million target, showing that even in these tough times for fundraising, firms with a compelling proposition and track record can achieve great success.

Fig. 1: Breakdown of Annual Venture Fundraising by Geographic Focus: 1998 - 2010 YTD



Source: Preqin

Fig. 2: Breakdown of Venture Firms by Geographic Location



Source: Preqin

Venture Fund Size

Fig. 4 illustrates the breakdown of venture capital firms by the largest fund they have raised or are currently raising, demonstrating that 78% of venture firms have never raised a fund greater than $250 million and only 8% of firms have raised a venture fund which has closed on $500 million or more.

Venture Fund Industry Preference

Venture capital is traditionally associated with high technology industries such as biotechnology and information technology due to their innovative nature and the potential rates of return from disruptive technology. Fig. 5 shows the industry preferences of venture funds that have closed between 2005 and 2010 and those funds that are currently in market seeking capital. Information technology remains the most popular industry for venture funds to invest in. The health care industry is also prominent, with over 35% of both closed funds and those fundraising seeking to include health care in their portfolios. It is also interesting to note that the industrials sector is listed as an industry preference by twice the proportion of funds currently raising compared to funds closed between 2005 and 2010.

Most Active Firms by Fundraising

Fig. 6 shows the largest firms by venture capital funds raised over the last 10 years. Oak Investment Partners and New Enterprise Associates have raised the most capital, each having raised $6.4 billion through four and five venture funds respectively. Sequoia Capital has raised the most funds of all firms in the top 10, with its 10 venture funds raising an aggregate $4.1 billion in the last 10 years.

Data Sources:

Preqin Funds in Market

Included as part of Preqin's integrated 360° online private equity database, or available as a separate module, Funds in Market provides detailed and extensive information on private equity funds seeking capital, including over 460 venture funds.

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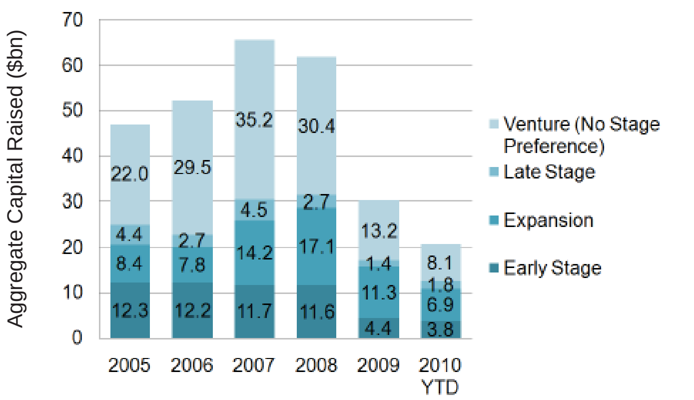
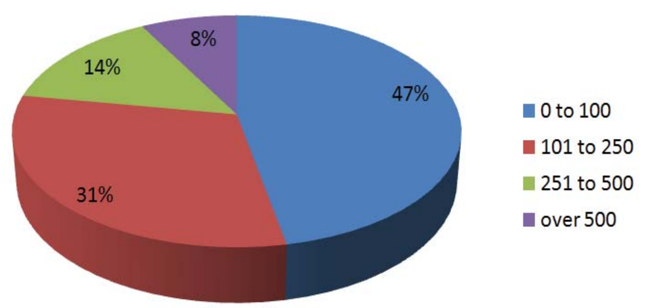
Fig. 3: Breakdown of Annual Venture Fundraising by Fund Type: 2005 - 2010 YTD



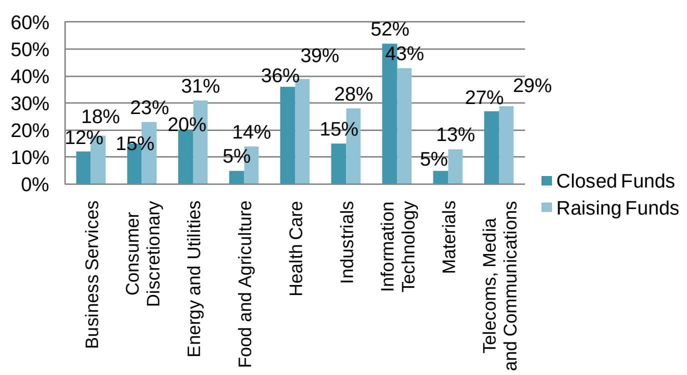
Source: Preqin

Fig. 4: Breakdown of Venture Firms by Largest Fund Raised or Currently Raising



Source: Preqin

Fig. 5: Breakdown of Venture Funds by Industrial Focus: 2005 - 2010 YTD



Source: Preqin

Fig. 6: Largest Firms by Venture Funds Raised in the Last 10 Years

Manager	Aggregate Capital Raised ($bn)	Number of Funds Raised
Oak Investment Partners	6.4	4
New Enterprise Associates	6.4	5
Citi Venture Capital International	5.8	3
Technology Crossover Ventures	5.3	3
Sequoia Capital	4.1	10
Carlyle Group	3.8	6
Kleiner Perkins Caufield & Byers	3.0	7
Austin Ventures	2.9	3
Accel Partners	2.9	8
Matrix Partners	2.8	5

Source: Preqin

Venture Performance

Preqin's Performance Analyst is the industry's most extensive source of net to LP private equity fund performance, with full metrics for over 5,100 named vehicles. In terms of capital raised, Performance Analyst contains data for over 70% of all funds raised historically.

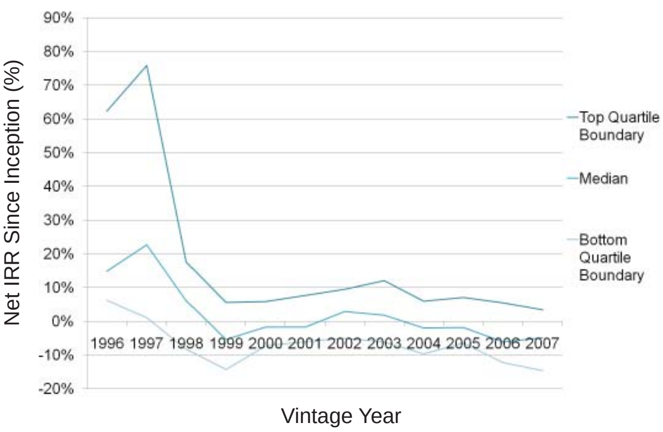
It is well known that the collective performance of venture capital funds over the past decade, since the crash of the technology bubble, has not lived up to expectations. Fig. 1, which is based on performance data for more than 700 venture capital funds (excluding early stage funds), shows the median IRR of venture funds by vintage for the years 1996 to 2007. Vintage 1997 funds have the highest median IRR of all of the vintages shown, at around 23%, and funds of this vintage require extremely high returns – in excess of 75% – to be considered a top quartile fund in terms of IRR. As Fig. 1 shows, the best performing vintage 1996 venture funds also produced impressive returns, with an IRR over 62% required for a fund to be in the top quartile for this vintage.

For the vintages following these, the technology crash affected the overall performance of venture funds, and returns have struggled to recover since. The median vintage 1998 venture fund has still produced a positive IRR, at just over 6%, and a 17.5% IRR is required for a fund to be in the top quartile. However, the median fund for each of the three following vintages has a negative IRR, and top quartile performance is also significantly lower.

Fig. 2 shows the proportion of venture funds for each vintage year from 1996 to 2007 that have achieved an IRR of 20% or more, portraying a similar story to that shown in Fig. 1. Nearly 35% of vintage 1996 venture funds in the sample, and more than half of vintage 1997 funds, have produced IRRs of 20% or more. Nearly one-fifth of vintage 1998 funds have also done so, but the figures then fall away further for vintages following this, with less than 5% of vintage 1999 and 2000 venture funds returning 20% or more. The figure for vintage 2005 funds suggests some improvement in venture fund performance, with nearly 20% of funds achieving an IRR of 20% or more, despite the median fund still being in the red. This demonstrates the importance of good fund selection for venture capital fund investors. The proportion of funds achieving an IRR of 20% or more is lower for both vintage 2006 and vintage 2007, but these funds have had less time to add value to their portfolio investments and are still early in their J-curves.

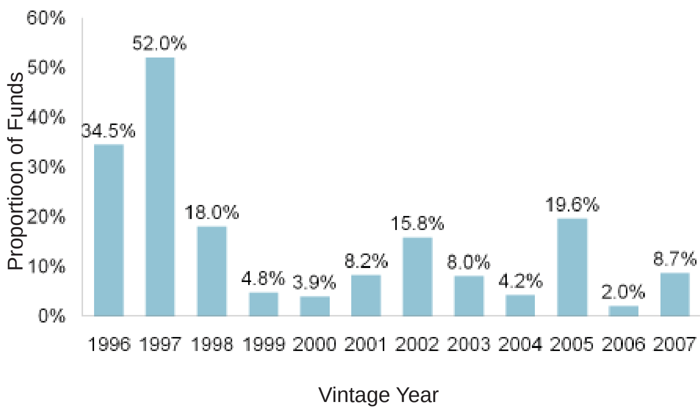
Fig. 3 shows the mean IRR and the standard deviation of IRRs for each vintage year for venture funds of vintages 1996 to 2007. For vintages 1996 to 1998, standard deviations are in excess of 45 percentage points, mainly due to the extremely large returns produced by some funds of these vintages (some funds in the sample have IRRs in excess of 500%). Following the burst of the technology bubble, standard deviations have been much lower, but appear to be trending upwards since the lows seen for vintages of the early 2000s, suggesting an increasing importance in fund selection. Vintage 2005 funds have one of the highest standard deviations of recent vintages, at around 25 percentage points, once more showing the variation in the performance of funds from this vintage. The mean IRR for vintage 2005 funds stands at just over 6%. When compared to the median IRR of -1.9%, this suggests that some funds of this vintage are significantly outperforming their respective median benchmarks. While the median venture capital fund's performance has fluctuated around 0% for vintages 1999 to 2007, investors with

Fig. 1: Venture Funds: Median Net IRRs and Quartile Boundaries by Vintage Year



Source: Preqin

Fig. 2: Proportion of Venture Funds Achieving an IRR of 20% or More



Source: Preqin

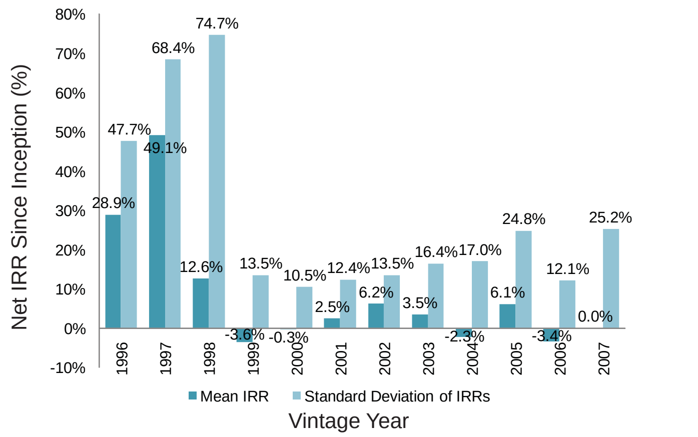
good fund selection skills are still able to achieve significant returns from the asset class.

Venture Assets under Management

Assets under management of venture fund managers rose steadily between 2003 and 2007, as illustrated in Fig. 5. Dry powder levels peaked in 2008, when venture firms held $163 billion as they began to hold back from making investments in the uncertain economic climate. The aggregate unrealized value of their portfolio companies fell somewhat in 2008 due to the downturn, before recovering the next year following the improvement in valuations in the second half of 2009.

Fig. 4 overleaf shows the top 10 performing venture funds. The fund universe was restricted to venture funds with fund sizes of at least USD 50 million. 1998 vintage Matrix Partners V tops the list, with a net IRR of 514.3%. Columbia Capital managed two of the top 10 performing venture funds – Columbia Capital Equity Partners I-A and I-B. Both were early stage funds, of vintages 1989 and 1995 respectively. I-A raised $73 million and achieved a net IRR of 198.5%, while its successor raised $90 million, and its net IRR was 192.3%.

Fig. 3: Venture Funds: Median Net IRR and Standard Deviationof IRRs by Vintage Year



Source: Preqin

Data Source:

Preqin Performance Analyst

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Preqin's Performance Monitor is the industry's most extensive source of net to LP private equity fund performance, with full metrics for over 5,100 named vehicles. In terms of capital raised, Performance Analyst contains data for over 70% of all funds raised historically.

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Fig. 4: Top 10 Performing Venture Funds *

Rank	Fund	Fund Manager	Vintage	Fund Size (Mn)	Type	Net IRR (%)
1	Matrix Partners V	Matrix Partners	1998	200 USD	Venture (General)	514.3
2	Benchmark Capital Partners II	Benchmark Capital	1997	125 USD	Venture (General)	267.8
3	Matrix Partners IV	Matrix Partners	1995	125 USD	Venture (General)	218.3
4	Focus Ventures I	Focus Ventures	1997	106 USD	Venture (General)	213
5	Columbia Capital Equity Partners I-A	Columbia Capital	1989	73 USD	Early Stage	198.5
6	Mayfield IX	Mayfield Fund	1997	252 USD	Venture (General)	195.7
7	Columbia Capital Equity Partners I-B	Columbia Capital	1995	90 USD	Early Stage	192.3
8	Accel V	Accel Partners	1996	150 USD	Venture (General)	188.4
9	Celtic House International Corporation	Celtic House Venture Partners	1998	241 USD	Early Stage	180.1
10	Sequoia Capital VII	Sequoia Capital	1996	150 USD	Early Stage	167.4

Source: Preqin

* Fund universe restricted to funds with sizes of over $50 million

Investors in Venture Funds

Preqin's Investor Intelligence database contains information on 2,167 venture capital investors from across the globe. Just under half (49%) are based in North America, almost a third (32%) are based in Europe and the remaining 19% are based in Asia and Rest of World.

Investor Intelligence monitors a broad range of investors in venture funds. Some 20 different LP types make up Preqin's venture investor universe, including fund of funds managers, public pension funds, private sector pension funds, endowment plans, foundations, family offices, banks, investment companies and sovereign wealth funds, amongst others.

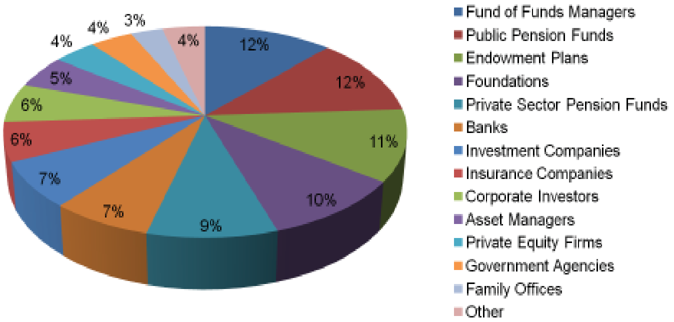
Fig. 1 shows that public pension funds and fund of funds managers represent the highest proportion of venture investors, each accounting for 12% of the investor community.

A number of US-based public pension funds include venture fund investments as part of a diverse portfolio of private equity fund interests. One such investor is Indiana State Teachers' Retirement Fund (TRF). The $4.2 billion pension fund has 7.2% of its overall assets allocated to private equity funds, of which 22% is invested in venture and early stage vehicles. It has made commitments to a number of venture funds currently raising or that have reached a final close in the last six months, including a $5 million commitment to California-based Opus Capital II, which is currently on the road seeking capital. Opus Capital Partners' fund is targeting $250 million to invest in early stage internet, software, networking and semiconductor companies in the US and Israel. TRF also allocated $13 million to Forbion Capital Partners' recently closed Forbion Venture Fund II, which is targeting investments in the life sciences sector in Europe and the US. TRF is included in Fig. 3, which lists 15 notable investors in venture funds that have closed in the last six months.

As discussed in other sections of this special report, venture has seen real growth in Asia. A significant proportion of capital for Asian funds is coming from domestic investors such as China-based Suzhou Ventures Group, which is focused on investing solely in domestic venture opportunities. The CNY 6 billion fund of funds manager is currently raising its latest venture-focused vehicle, SIP Venture Capital Fund of Funds II, which is targeting overall commitments of CNY 5 billion. Suzhou Ventures Group tends to focus on investments in start-up and early stage growth funds, mainly in the IT, bio-medicine, energy and environmental protection fields, but the firm aims to create a diverse portfolio and will consider opportunities in all sectors and across all venture stages.

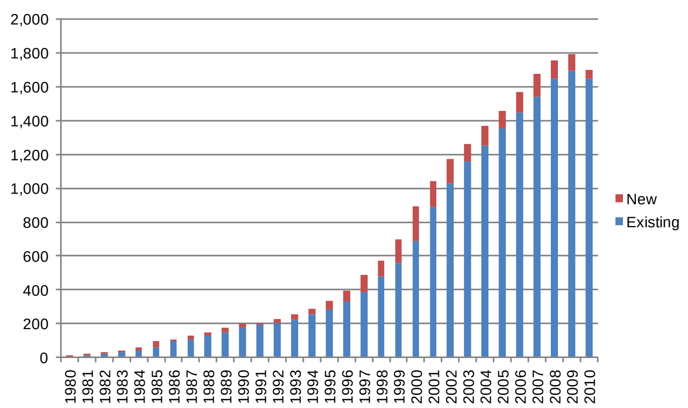
Fig. 2 shows the number of venture firms active since 1980. The total number of venture capital firms in the industry peaked in 2009, when there were 1790 firms active in the market. The number of new firms entering the market peaked in 2000, when 204 new firms entered the industry. A number of these firms have not raised a fund since then, and are now considered to be inactive (assuming a 10-year fund life), meaning that the total annual number of currently active venture firms has fallen for the first time.

Fig. 1: Make Up of Investor Universe by Type



Source: Preqin

Fig. 2: Number of Venture Firms Active, 1980 - 2010 YTD



Source: Preqin

Fig. 3: Notable Investors in Recently Closed Venture Funds

Investor	Investor Type	City	Assets under Management ($bn)	PE Allocation ($bn)	Proportion of PE Portfolio in Venture Funds (%)	Recent Venture Funds Invested In
Alaska Retirement Management Board	Public Pension Fund	Juneau	13	1	27%	Battery Ventures IX; Oak Investment Partners XIII
California Public Employees' Retirement System (CalPERS)	Public Pension Fund	Sacramento	205	30	16%	CalCEF Angel Fund; Chrysalix Energy III; Rembrandt Venture Partners II
Credit Suisse Customized Fund Investment Group	Fund of Funds Manager	New York	25	25	N/A	Chrysalix Energy III; Early Stage Partners Fund II
European Investment Fund	Fund of Funds Manager	Luxembourg	5	5	N/A	Chalmers Innovation Seed Fund AB; Forbion Venture Fund II; Leapfrog Microfinance Inclusion Fund; WHEB Ventures Private Equity Fund II
European Regional Development Fund	Government Agency	London	4	N/A	N/A	Brandenburg Früphasen Fonds; Exceed - Midlands Advantage Fund
Indiana State Teachers' Retirement Fund	Public Pension Fund	Indianapolis	4	0.3	22%	DCM VI; Forbion Venture Fund II; Oak Investment Partners XIII
International Finance Corporation (IFC)	Government Agency	Washington	N/A	3	N/A	Bancroft III; Ignia Fund I; Leapfrog Microfinance Inclusion Fund
Los Angeles Fire and Police Pension System	Public Pension Fund	Los Angeles	12	1	15%	DCM VI; Drug Royalty II; NGN BioMed Opportunity Fund II
Massachusetts Pension Reserves Investment Management Board	Public Pension Fund	Boston	44	4	15%	Battery Ventures IX; Polaris Venture Partners VI; Rembrandt Venture Partners II; SV Life Sciences Fund V
Omidyar Network	Investment Company	Redwood City	0.2	0.01	100%	Ignia Fund I; Leapfrog Microfinance Inclusion Fund
San Francisco City & County Employees' Retirement System	Public Pension Fund	San Francisco	13	1.7	17%	DCM VI; Polaris Venture Partners VI
Small Industries Development Bank of India	Investment Bank	Lucknow	7	0.1	N/A	SME Growth Fund II
Soros Economic Development Fund	Foundation	New York	0.1	N/A	100%	Ignia Fund I; Leapfrog Microfinance Inclusion Fund
State of Wisconsin Investment Board	Public Pension Fund	Madison	78	4	7%	Drug Royalty II; Oak Investment Partners XIII
West Midlands Pension Fund	Public Pension Fund	Wolverhampton	12	1	5%	DCM VI; Atomico Ventures II

Source: Preqin

Data Source:

Preqin Investor Intelligence Database

Preqin's Investor Intelligence database currently monitors 2,167 global investors in venture funds of all types from early stage through to expansion and late stage vehicles. In total, these investors are managing approximately $1.7 trillion in private equity assets.

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